

The Social Impact Investment Ecosystem in Germany

Input for the meeting of the Social Impact Investing Taskforce established by the G8
Berlin, 18-19 February 2014

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1 Introduction

The concept of social impact investing that has emerged in the Anglo-Saxon world is relatively new to Germany. Knowledge of this approach and of international developments in the field is only gradually starting to spread beyond a small group of informed actors. This fact is reflected in the relatively modest cumulative market size of investments by social investors into socially-motivated organisations in Germany, which was estimated to be EUR 24m at the end of 2012.

For the market to grow and to unlock its full potential, the concept of social impact investing must be adapted to the specific conditions governing the provision of social services in Germany. Social impact investing has thus far developed fastest and most successfully in the Anglo-Saxon world of liberal welfare states. The extent to which the particularities of the local context – in the case of Germany, the long tradition of corporatist welfare provision – shape market conditions will have to be tested in practice and will necessarily influence the way in which the concept of social impact investing is introduced into the German ecosystem. However, provided that the social impact investing approach gains acceptance within the established institutions of social service provision and given that demand by socially oriented start-ups and SMEs appears to be growing, it holds significant potential for achieving widespread change and creating greater social impact within communities.

In addition, German actors – both investors as well as impact investing intermediaries – may also contribute to positive social change outside of Germany in developing or emerging countries.

2 Social Impact Investing in Germany

2.1 Market Definition

We use the term social impact investing as the provision of finance to an organisation, company or fund with the expectation of both social and financial returns. This implies that social returns and the measurement of it are a vital part of the investment strategy, which clearly distinguishes social impact investing from socially responsible investing that aims to avoid negative impacts.

Additionally, impact investors expect financial returns, which can range from the pure repayment of capital (i.e. 0% of return) up to a market rate of return, clearly excluding any form of philanthropy from social impact investing. In other words, this definition includes only socially-motivated investments provided to socially-motivated organisations, companies or funds. Mainstream lending or traditional sources of finance to social organisations are not considered social impact investment, because the lenders are not primarily aiming to maximise social value and therefore do not measure social impact. In theory, social impact investments include a wide range of financial products in various asset classes. Social impact investments can also be combined with philanthropic capital in so-called hybrid financing models (e.g. when a grant pays for the interest of an impact investing loan).

A detailed overview of financial products and channels which are consistent with this market definition and have been used to estimate the market size is depicted in Figure 1 below.

Social impact investment 2012				
	Direct investments	Social funds	Social banks / alternative banks	Other intermediaries
Secured loans			X	
Unsecured loans	X	X		
Equity / Quasi-equity	X	X	X	
Other (e.g. bonds)			X	
Total	EUR 0.5-1m	EUR 3-5m	EUR 7.9bn	TBD
Socially-motivated investments into socially-motivated organisations (impact measurement)			Traditional sources of finance for social organisations (lack of impact measurement)	

Figure 1: The German social impact investing market by financial product and channel ¹

2.2 Market Size

The German social impact investing market is in a very early stage of development with few active players. The current (cumulative) market size of investments by social investors into socially-motivated organisations was estimated at EUR 24m² at the end of 2012. New investments in the year 2012 amount to approximately EUR 4-5m. An estimated average of 10-15 deals are closed per year (i.e. deals above EUR 100k, including new rounds of portfolio companies). The German market is still relatively limited compared to more mature markets like the UK with an annual investment volume of EUR 183-244m³ in 2012. It also appears small compared to traditional sources of finance for social organisations (e.g. EUR 7.9bn loans provided to social organisations by the five largest social banks⁴), the German microfinance industry (EUR 5.3bn funds invested in Germany⁵) or the volume of renewables financing in Germany (EUR 15bn⁶). These categories are often subsumed under the term “impact investment”, but do not comply with our market definition due to a lack of appropriate impact measurement. Yet these large investment categories give a good impression of the future potential of impact investing. The organisation “Forum Nachhaltige Geldanlagen” (an industry association promoting sustainable investment in Germany), which does not take into account the criterion of social impact measurement, stipulates a volume of EUR 1,19bn (2012) for impact investments in Germany (including funds invested outside of Germany).⁷

At this point, few players are active in social impact investing within Germany and most funds are invested through intermediaries. The market within Germany is highly concentrated with the two largest intermediaries, BonVenture and the Social Venture Fund, together responsible for more than two thirds of the capital invested in 2012. Third biggest investor is the state-owned development bank Kreditanstalt für Wiederaufbau (KfW) which invests through its matching fund programme for social enterprises.

These players are mainly funding social ventures in their growth phase with mezzanine capital (majority of funds invested), debt or equity. At this stage, the German market lacks a diversity of products, but some market agents (such as Impact in Motion or FASE⁸) are actively trying to broaden the spectrum of social investment instruments. In 2014, we may also see the closing of the first German Social Impact Bonds developed by Benckiser Stiftung.

¹ Impact in Motion (2013).

² Weber and Scheck (2012).

³ Big Society Capital (2013).

⁴ Loans provided from GLS, Bank für Sozialwirtschaft, Triodos, Umweltbank and Ethik Bank to social organisations in 2012.

⁵ KfW (2008).

⁶ Renewable Energy Policy Network for the 21st Century (2013).

⁷ Forum Nachhaltige Geldanlagen (2013).

⁸ Finanzierungsagentur für Social Entrepreneurship, a German financing agency for social entrepreneurship.

2.3 Key Actors

The German social impact investment market involves three important groups of players: investors, investees (socially-motivated organisations) and intermediaries.

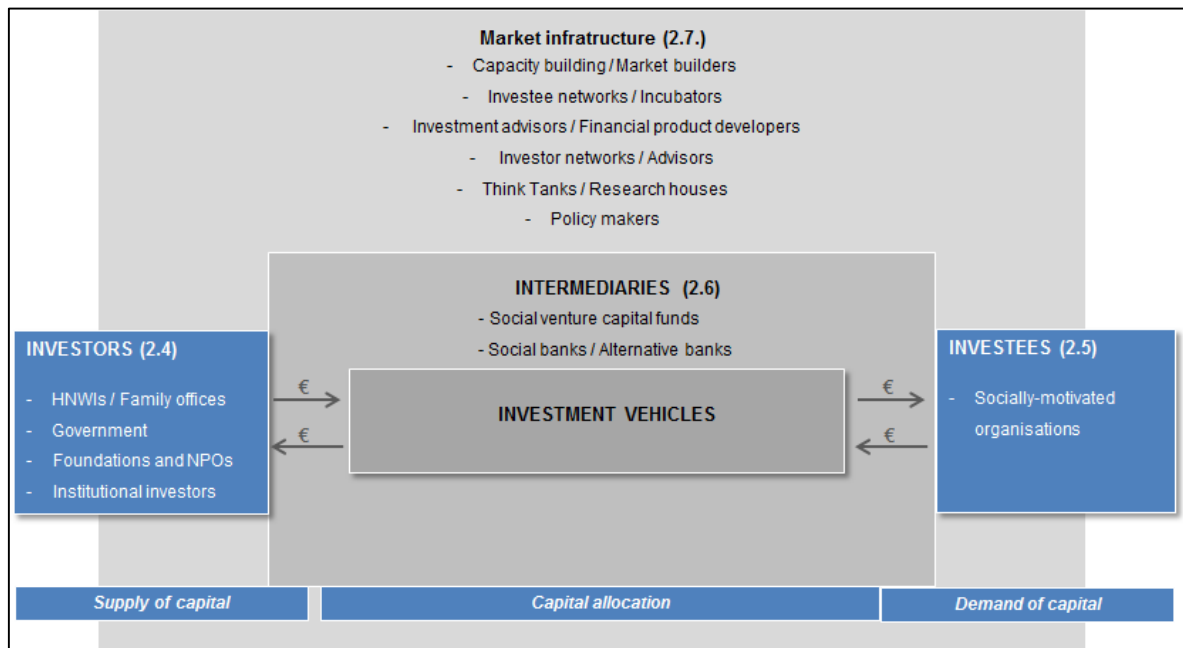


Figure 2: The impact investing ecosystem⁹

2.3.1 Investors

The main investors in the German social impact investing market are private philanthropists (i.e. high net worth individuals, HNWI) the German Government, and to a far lesser extent foundations and non-profit organisations. Future market growth, however, will depend on accessing new groups of investors - particularly institutional investors – which thus far play only a minor role.

Private philanthropists and their family offices, such as the families who founded BonVenture in 2003, have been the most active group pioneering the German social impact investing market. Private philanthropists typically have an entrepreneurial background and see impact investing as a complement to their philanthropic activity. There are approximately 5-10 experienced Business Angels directly investing larger sums (>100k) in the German social impact investment market. A new crowdfunding platform for social start-ups (Social Impact Finance) has been set up in 2013 by the Germany incubator Social Impact Lab. The platform is supported by Deutsche Bank. Overall, investment opportunities for private philanthropists remain scarce given that BonVenture is only targeting a limited investor circle and both large social venture capital funds require high minimum investment levels for private investors. Interestingly, there is a number of non-German philanthropists investing in Germany¹⁰.

Compared to other national markets, the **German government** has been significantly less active in developing the social impact investment sector. One major government initiative within Germany specifically targeted towards social enterprises so far has been the initiation of the KfW financing programme for social enterprises. Through this programme, KfW has invested roughly EUR 1m in 7 deals since January 2012¹¹, which makes them the most active investor (in terms of number of deals) in Germany over this period. The German social impact investing market is also likely to benefit from European initiatives in this field, like the Social Business Initiative Fund (EUR 90m for impact investments in Europe from 2014-2020) and the matching programme of

⁹ Impact in Motion (2013).

¹⁰ Approximately 70% of investors of the Social Venture Fund are non-German (i.e. mainly from Switzerland, the UK and other European countries).

¹¹ Stefan Frings, Senior Investment Manager Beteiligungsgeschäft, KfW.

the European Investment Fund (matching private investment capital into social impact investment vehicles up to EUR 50m).

The current involvement of **charitable foundations and non-profit organisations** as investors in the German market is limited – also due to an unfavourable legal framework with regard to the charitable status of these organisations. Auridis gGmbH is an example on a non-profit organisation providing repayable funds to social enterprises. Due to the growing trend towards mission investing, charitable foundations could become more active investors in future. Important players promoting mission investing are the Association of German Foundations and the Eberhard von Kuenheim Stiftung of BMW AG.¹² Overall, foundations and non-profit organisations might lack financial resources to substantially grow and develop the German social impact investing market as investors, but they are certainly crucial in early-stage financing of social ventures with philanthropic capital.

In the longer term, **institutional investors** (including banks, investment funds, pension funds, and corporations) are likely to play a vital role in developing the market both within Germany. They are, however, difficult to attract at this point due to limited expectation of risk-adjusted financial return, a low number of deals and low liquidity of investments. HypoVereinsbank (subsidiary of Unicredit) and Deutsche Bank are among the first German institutional investors in the social impact investing market.¹³ Deutsche Bank, for example, is a member of the Global Impact Investing Network investors' council which includes investors holding a minimum of USD 50 million in impact investing assets. With Tengelmann¹⁴ Social Ventures, the first Corporate Venture Capital player in Germany has entered the field of impact investing in December 2013.

2.3.2 Socially-Motivated Organisations

On the demand side of the market, there are socially-motivated organisations delivering social and environmental benefits. These organisations are not limited to a specific income source or any particular type of activity. They also come in a variety of different legal forms (e.g. private, public, non-profit), but in order to scale and develop, many socially-motivated organisations have adopted a costly hybrid legal structure (a non-profit unit combined with a for-profit unit) in order to work around the complex limitations of German charitable law. It is estimated that there are more than 600,000 social organisations in Germany and more than 1,000 social enterprises according to the research institute CSI.¹⁵ Socially-motivated organisations seek financial capital for the following reasons:

- as working capital to help with cash flow management;
- as development capital to scale;
- to acquire the fixed assets necessary to deliver ongoing services;
- as reserves or insurance to hedge against the unexpected.

Main sources of funding for socially-motivated organisations are grants, government funds or traditional financial products (such as bank loans). There appears to be large evidence that there is a financing gap, especially for young social enterprises in Germany with capital requirements in the range of EUR 10k- 500k.¹⁶ In order to grow the German social impact investment market, it will be crucial to develop new financing models (e.g. hybrid financing instruments) that meet the needs of these socially-motivated organisations and to help them build up professional capacity to become investment ready.

Social impact measurement is still in its infancy among socially-motivated organisations in Germany. In fact, most organisations that measure impact do so because they received funds from a social investor or venture

¹² Some German foundations, such as Social Business Stiftung and Siemens Stiftung are very active in promoting impact investing outside Germany, mainly in developing countries.

¹³ Both investors in Social Venture Fund II.

¹⁴ Tengelmann is a large German corporate active in food retail. .

¹⁵ Scheuerle, T. et al. (2013).

¹⁶ Weber and Scheck (2012).

philanthropist. In order to address the lack of common standards for impact reporting, the Social Reporting Standard (SRS) has been developed by a broad alliance of 11 impact investing multipliers in 2011.¹⁷

2.3.3 Intermediaries

Intermediaries connect investors and investees by attracting money from different investor groups and helping socially-motivated organisations acquire funding. Intermediaries also support the investees through management know-how and professional contacts to help them grow successfully. The most important intermediaries in Germany at this point are the two large social venture capital funds. Social banks could play an important role in the German social impact investing market in the future as they already offer sustainable investment products, but still lack social impact measurement of their investments. Other potential intermediaries, such as traditional investment companies are not yet present in this field in Germany.

There are currently two large **social venture capital funds** – BonVenture (founded in 2003) and the Social Venture Fund (founded in 2009) - with a combined total of around EUR 40m under management. These funds provide equity, mezzanine capital and debt to social ventures in the range of EUR 200k-1.5m. BonVenture currently invests through its second fund in the German-speaking region (DE, AT, CH). The Social Venture Fund¹⁸ holds the majority of its investments within Germany, but aims for a pan-European investment scope. It has closed its second fund in December 2013 (first closing at EUR 16.4m), presumed to be one of the largest in Europe. Due to a minimum investment of EUR 100-500k for these funds, it is mainly HNWI, (non-German) foundations and institutional investors providing the required capital. So far, these funds have screened more than 3,000 investment opportunities. Funding has been provided to 29 socially-motivated organisations in Germany, of which 9 have already been exited from investors' portfolios¹⁹.

Social banks (also called alternative banks) collect funds from small retail investors and pass them on to social organisations, such as schools, hospitals, renewable energy or organic agriculture projects. Main players offering sustainable investment products are Ethik Bank, GLS Bank, Triodos Bank and Umweltbank. Furthermore, the free welfare organisation-owned Bank für Sozialwirtschaft is an important player in financing social organisations (especially real estate financing). Triodos through its Europe-wide impact investing fund and to a lesser extend Umweltbank which is mainly active in renewable energy and have already started to evolve towards systematic impact measurement. In the medium term, social banks have the potential to play an important role in the German social impact investing market, as in the UK²⁰, where they are the largest intermediaries in the market.

2.4 Market Infrastructure

The development of market infrastructure will have a significant impact on the evolution of the social impact investing market in Germany. At this early stage, the infrastructure enabling a transparent and efficient social impact investment market is weak and concentrated on few active players (see figure 4 below). Important organisations providing operational and financial support to build up these organisations (capacity-building) are Bertelsmann Stiftung, BMW Stiftung Herbert Quandt and Ashoka Deutschland. Overall, the German market needs continued and increased capacity-building efforts to be able to develop. In more mature markets, powerful organisation like Rockefeller Foundation, Omidyar Network or Esmée Fairbairn Foundation and personalities (like Sir Ronald Cohen) with a significant operational and financial capacity have taken over this role.

¹⁷ The Social Reporting Standards have been developed by 11 industry organisations including Ashoka Deutschland, BonVenture, The Federal Ministry of Family Affairs, Senior Citizens, Women and Youth, Phineo, and the Schwab Foundation.

¹⁸ Now managed by Ananda Ventures.

¹⁹ BonVenture (2013) and Social Venture Fund (2013).

²⁰ Big Society Capital (2013): Largest social impact investors in the UK are social banks, like the charity bank.

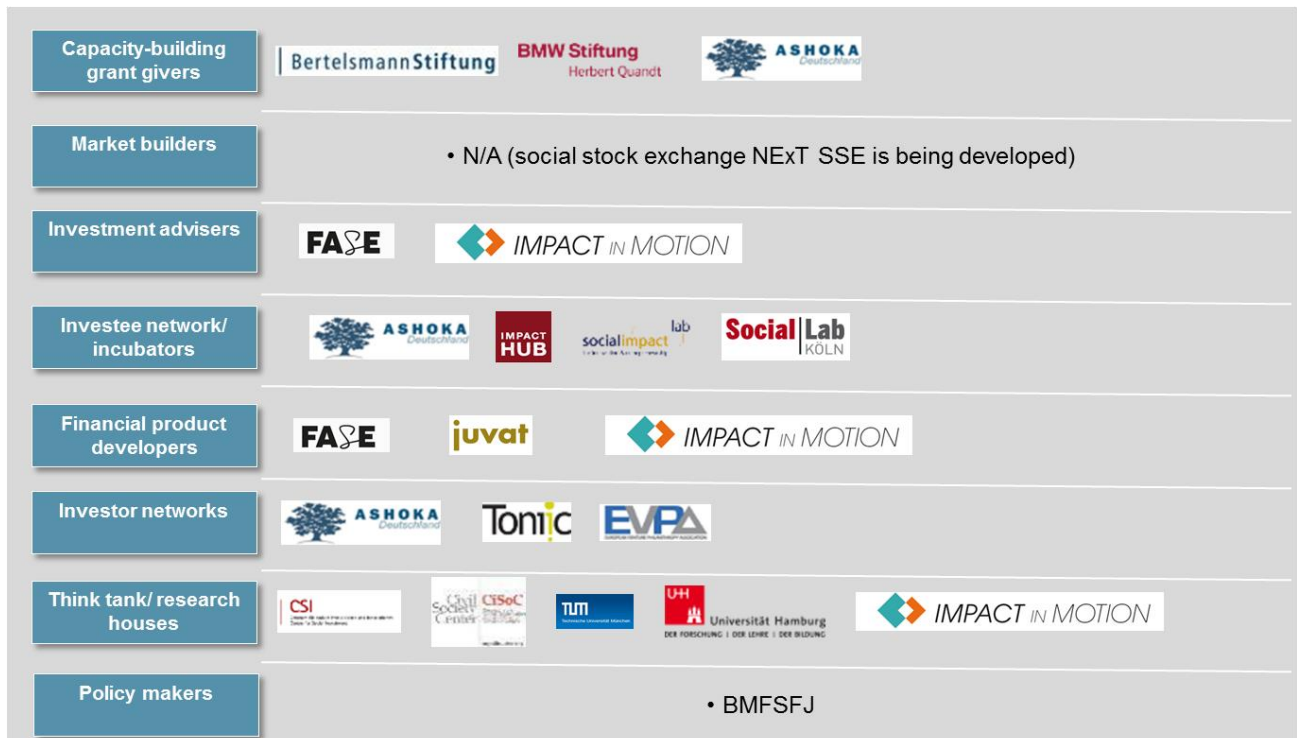


Figure 3: Infrastructure of the German social impact investing market²¹

2.5 Existing Challenges

Growth expectations for the German social impact investing market remain vague. In order to unlock further growth potential in the sector, Impact in Motion's thorough sector analysis in 2012 has identified the following key challenges which must be addressed:²²

- The absence of large-scale investors able to sufficiently capitalise the market;
- A shortage of investable social organisations (i.e. weak organisational capacity of socially-motivated organisations and low investment readiness);
- The lack of investable standardised financial products and intermediaries (e.g., no dedicated fund products for foundations' PRI);
- A weak supporting market infrastructure enabling investors and investees to connect efficiently (such as consulting services, platforms, think tanks);
- A difficult legal framework (esp. with regards to the charitable status of foundations and organisations) and the absence of tax incentives for impact investors;
- Lack of clarity with regard to appropriate government intervention.

²¹ Impact in Motion (2013).

²² Weber and Scheck (2012).

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